In the Matter of
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Verizon Petition for Waiver of Pricing	)	WCB Docket No. 04-246
Flexibility Rules for Fast Packet Services	)	

REPLY OF SBC COMMUNICATIONS INC TO AT&T'S OPPOSITION TO VERIZON'S PETITION FOR WAIVER TO EXERCISE PRICING FLEXIBILITY OF ADVANCED SERVICES

SBC Communications Inc. ("SBC") hereby submits these reply comments in response to AT&T's Opposition to Verizon's Petition for Waiver of the Commission's pricing flexibility rules to take advantage of pricing flexibility for its advanced services that rely on packetized technology in areas where Verizon has received pricing flexibility for traditional special access services. As SBC demonstrates below, the Commission should reject AT&T's baseless arguments and grant Verizon and similarly situated ILECs the waiver relief requested.

AT&T argues that a petition for waiver of the pricing flexibility rules is an inappropriate vehicle for the relief Verizon seeks. AT&T argues that Verizon has failed to show that special circumstances exist justifying a waiver. AT&T argues that Verizon has failed to show that there is effective competition in the advanced services market. AT&T argues that if Verizon is granted pricing flexibility for its advanced services, there would be an increased likelihood that Verizon could engage in a predatory price squeeze. Further, AT&T argues that pricing flexibility for Verizon's advanced services is not warranted at this time because the Commission is already considering relief for ILEC broadband services in the *Dom/Nondom* and *Wireline Broadband* proceedings. As SBC demonstrates below, the Commission should reject these arguments.

First, AT&T is wrong that packet switched services were specifically excluded from price caps by the Commission in the *1990 Price Cap Order*.[1] To be sure, the Commission in that Order excluded packet-switched services in existence at the time because they "were not subject to scrutiny as part of [its] investigation of LEC productivity."[2] However, AT&T cannot refute that the Bureau *and* Commission have permitted price-cap LECs to treat new packet-switching services introduced after 1990 as new services under Section 61.42(g).[3] In 1996, for example, BellSouth included its packet-switched services in price caps pursuant to Section 61.42(g) and later sought pricing flexibility for those services, which WorldCom challenged. The Commission ultimately rejected WorldCom's arguments, finding that the services were subject to Bureau scrutiny, that the services were properly regulated under price caps and that the services were eligible for pricing flexibility.[4] Further, the Bureau has granted Verizon waivers of 61.42(g) to *exclude* packet-switched services from price caps, which plainly would not have been necessary if the *1990 Price Order* required the exclusion of those services from price caps.[5] The existing rules do not preclude a BOC from incorporating new packet-switched services into price caps, nor do they preclude a carrier from obtaining pricing flexibility for such services, as AT&T claims.

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[1] *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786 (1990) (*1990 Price Cap Order*).

[2] *Id.* ¶ 195.

[3] *BellSouth Petition for Pricing Flexibility for Special Access and Dedicated Transport Services, Memorandum Opinion and Order*, CC Docket No. 01-22 (October 3, 2000) (*BellSouth Pricing Flexibility Order*).

[4] *Id.* at 15.

[5] *See, e.g., Verizon Petition for Interim Waiver of Section 61.42(g) of the Commission's Rules*, 18 FCC Rcd 6498 (2003); *Verizon Petition for Interim Waiver of Sections 61.42(g), 61.38 and 61.49 of the Commission's Rules*, Order, WCB/Pricing No. 02-16 (2002).

Second, contrary to AT&T's claims, Verizon's waiver demonstrated that special circumstances exist to justify a waiver. Absent a waiver, Verizon would lack the flexibility necessary to compete effectively in the broadband marketplace. Today, AT&T as well as other non-ILEC broadband providers have the flexibility to customize their broadband offerings in response to consumer demand, and further can proactively create innovative pricing offerings to attract customers – all without having to file tariffs or cost support. Verizon and other similarly situated ILECs have no such flexibility and thus are hampered in their ability to respond competitively to consumer demand. The Commission has long held that pricing restraints inhibit a carrier's ability to respond to competition in the marketplace and offer consumers new and innovative service and pricing options.[6] Even AT&T argued as much when it sought nondominant status.[7]

Third, there is robust competition in the advanced services market. AT&T asserts that CLECs and intermodal competitors, such as cable and satellite providers, are not effective competitors to the BOCs in the broadband market, but the Commission itself has found to the contrary. In the *Triennial Review Order*, for example, the Commission concluded that the record demonstrated that "a wide range of competitors" offer packet-switched services and that "competitive LEC deployment of packet switching has doubled…"[8] Further, recent industry reports show that non-LECs are competing effectively in the advanced services market. Cable firms, for example, continue to be the predominant provider of broadband services in the residential and small business

[6] *See Pricing Flexibility Order*, ¶¶ 1, 3, 14, 19; Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd 3271, ¶27 (1995) (*AT&T Nondominant Order*).

[7] *AT&T Nondominant Order*, ¶16 ("AT&T claims that, despite loss of market power, it continues to be subjected to 'burdensome and unequal' regulation that unfairly advantages its competitors and deprives consumers of price reductions and innovative service offerings.").

[8] *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC docket No. 01-338, ¶ 536 (2003) ("*Triennial Review Order*").

markets.[9] In fact, one recent report shows that cable companies served about 17.4 million broadband customers as of March 2004.[10] And many cable firms are now proactively targeting businesses for their broadband services.[11] Other intermodal competitors, such as wireless and satellite providers, are also increasing their presence in the broadband market and thus must be considered in determining the competitiveness of the residential and small business broadband market.[12]

As for the larger business market, AT&T, MCI, Time Warner and others are the predominant providers of advanced services.[13] AT&T in particular has a significant competitive advantage in this market due to name recognition. Further, because larger business customers typically enter long contractual arrangements for such services and generally do not switch providers at the same rate as residential and small business customers, predominant broadband providers like AT&T enjoy a first mover advantage. AT&T does not even attempt to dispute these facts and, indeed, has trumpeted to Wall Street that its mission is "to *widen* the gap between AT&T and [its] competitors in the business market…"[14]

Fourth, AT&T, not surprisingly, grossly overstates the extent to which it and other IXCs must rely on BOC special access services. As the Commission concluded in

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[9] National Economic Research Associates Inc., Ex Parte Declaration of William E. Taylor, WCB Docket No. 02-112 (August 10, 2004) ("NERA Report").

[10] NCTA Industry Overview, http://www.ncta.com/Docs/PageContent.cfm?pageID=86, accessed July 22, 2004.

[11] NERA Report at 6.

[12] *Id.* at 7.

[13] In SBC's territories, AT&T, Time Warner and MCI account for two-thirds of the large business market for advanced services.

[14] AT&T Press Release: AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets, July 22, 2004.

the *Triennial Review Order*, "several [competitive] carriers maintain their own frame relay and ATM networks, with AT&T, WorldCom and Sprint each operating extensive, nationwide networks."[15] AT&T in particular has deployed a significant amount of alternative transmission facilities in metropolitan area networks, serving thousands of business customers.[16] The fact is, as AT&T is fully aware, special access customers are geographically concentrated in a limited number of wire centers and a small number of buildings in those wire centers.[17] This high degree of concentration generates significant economies of scale, thereby reducing a carrier's cost of extending facilities to reach new customers. Thus, AT&T and other IXCs can, through targeted investment, extend their existing networks to reach buildings housing customers that account for over 90 percent of all special access revenues. [18]

Recent reports support these conclusions, demonstrating that competitive LECs are continuing to build their own networks. For example, since 1996, competitive providers have invested over $70 billion in new infrastructure, the majority of which to serve enterprise customers.[19] In fact, the number of CLEC-deployed switches and fiber-routes has increased exponentially and many CLECs now provide broadband services using their facilities alone.[20] Further, other competitors that use completely separate platforms, such as cable, wireless, and satellite providers, are now targeting enterprise

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[15] *Triennial Review Order*, ¶ 536.

[16] Opposition of SBC Communications Inc., AT&T Corp., Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services, RM No.10593, 32-33 (December 2002).

[17] *Id.* at 33.

[18] *Id.*

[19] ALTS, The State of Local Competition 2003, at 10 (April 2003).

[20] *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, UNE Fact Report 2002, CC Docket No. 01-338, I1-I10 (2002).

customers, further dispelling any notion that competitive providers must rely on BOC special access services to compete in the broadband market.[21]

Fifth, Verizon could not succeed in a predatory price squeeze, as AT&T claims. A price squeeze would only prove profitable here if Verizon could (a) drive its advanced telecommunications competitors from the market and (b) erect sufficient barriers to preclude re-entry or new entry into the market after Verizon raised its advanced services rates.[22] To accomplish this, Verizon first would have to sacrifice revenues for a sufficient period of time to drive away all of its competitors. Next, Verizon would have to buy all of the competitive fiber in its operating territories to prevent potential competitors from entering the market. Then, Verizon would have to raise its prices sufficiently above competitive levels to recoup its losses. The foregoing of course assumes that there is no new entry into the market in response to Verizon's higher prices and further that Verizon's actions would escape Commission and antitrust regulators. Clearly, such a sequence of events is inconceivable. In the words of the Supreme Court,

> The success of any predatory scheme depends on maintaining monopoly power for long enough both to recoup the predator's losses and to harvest some additional gain…For this reason, there is a consensus among commentators that predatory pricing schemes are rarely tried and even more rarely successful.[23]

In any event, given that cable, wireless and satellite providers are players in the advanced services market, using their own platforms to serve mass market and business customers,

[21] NERA Report, at 6-7.

[22] *See generally*, Raymond L. Gifford & Adam Peters, The Fallacy of Predation in Wireline Communications (Aug. 2004).

[23] *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

the BOCs could not drive competitors from the advanced services marketplace even if they had bottleneck control over special access services, which they do not.

Further, AT&T is wrong that Verizon and the other ILECs are charging anticompetitive prices for special access services in areas where they have received pricing flexibility.[24] To the contrary, SBC offers its customers a number of discount pricing options for its special access services in such areas and AT&T, in particular, has availed itself of some of these offerings.[25] The fact that some ILECs may not have lowered their special access rates in areas where they have received pricing flexibility to mirror price cap rates is not evidence that their pricing flexibility rates are unreasonable. Besides, AT&T and other IXCs continue to dominate the retail market for packet-switched services which is dispositive proof that they are able to obtain ILEC special access inputs at competitive rates.

Finally, contrary to AT&T's claims, Verizon is not seeking the same relief here that it seeks in the pending broadband proceedings. There, the BOCs seek complete deregulation of their advanced services, which would eliminate all tariff requirements for these services. Here, Verizon is seeking only the level of pricing flexibility relief it has been *granted* for its traditional special access services. Importantly, Verizon and any other ILEC would remain subject to the Commission's tariffing requirements for new services.

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[24] AT&T Opposition at 23.

[25] AT&T for example purchases OC3, OC12 and Access Advantage Plus special access services from SBC pursuant to pricing flexibility contracts.

Conclusion

For the foregoing reasons, the Commission should grant Verizon's waiver request to permit Verizon and other ILECs to take advantage of pricing flexibility for their advanced services in areas where that carrier has received pricing flexibility for special access services.

Respectfully Submitted,

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